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No. 80-1496

IN THE
Supreme Court of the United States
OCTOBER TERM, 1981

UNDERWRITERS NATIONAL ASSURANCE COMPANY

Petitioner,

vs.

NORTH CAROLINA LIFE AND ACCIDENT AND HEALTH INSURANCE GUARANTY ASSOCIATION; JOHN RANDOLPH INGRAM, COMMISSIONER OF INSURANCE OF THE STATE OF NORTH CAROLINA; AND HARLAN E. BOYLES, TREASURER OF THE STATE OF NORTH CAROLINA,

Respondents.

ON WRIT OF CERTIORARI TO THE NORTH CAROLINA COURT OF APPEALS

BRIEF FOR THE RESPONDENTS

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COUNTER-QUESTION PRESENTED

The North Carolina courts declined to give full faith and credit to an Indiana rehabilitation court's abrogation of statutory rights of North Carolina policyholders in a deposit placed in trust in North Carolina by an insolvent insurer domiciled in Indiana. The deposit was made with the North Carolina Treasurer "for the sole benefit of North Carolina policyholders," and North Carolina law prescribes the rights of those policyholders in the deposit. The Indiana court gave no notice that it intended to adjudicate rights in the North Carolina deposit, and the deposit was never mentioned in either the rehabilitation proceeding or in the final Planof Rehabilitation.

The question presented is whether the Indiana court had the requisite jurisdiction to adjudicate rights in the North Carolina deposit and whether the North Carolina courts must give any such judicial determination full faith and credit.

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BRIEF FOR THE RESPONDENTS

The Respondents concur with the sections entitled "Parties Below" and the "Jurisdiction of the Supreme Court" in the Brief for the Petitioner filed by Underwriters National Assurance Company ("UNAC"). The section entitled "Questions Presented" in UNAC's brief differs substantially from that section in UNAC's Petition for Certiorari, but does not appear to raise issues not raised in the Petition for Certiorari. The Respondents also concur with the section entitled "Constitutional Provisions and Statutes Involved" in UNAC's brief save for the reference to Article I, Section 8, Clause 3 of the Constitution, which was not properly raised below.

The Respondents have included a brief Chronology of Events, beginning at page 1-A of the Appendix to this brief for the convenience of the Court.

STATEMENT OF THE CASE

The Deposit and the Parties. The Petitioner, UNAC, is an Indiana stock insurance company. Prior to its insolvency, it was licensed to do business in 45 states, including North Carolina, as well as in several foreign countries. After determining that UNAC's financial condition was questionable, the North Carolina Department of Insurance, by letter dated June 13, 1973, informed UNAC that a $100,000.00 deposit would be required as a condition to allowing UNAC to do business in North Carolina. (R. 23, Ex. Bd. 1)[1] By Letter dated June 18, 1973, UNAC stated that it was taking the necessary steps to place a $100,000.00 deposit with the North Carolina Department of Insurance to be held for the *"sole benefit of North Carolina policyholders."* (Emphasis added.) (R. 23, Ex. Bd. 2) By letter dated July 19, 1973, and attachments thereto, UNAC acknowledged that the securities were to be held in trust on behalf of North Carolina policyholders of UNAC. (R. 23, Ex. Bd. 4-7)[2]

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[1]References to the Record and to the separately paginated Exhibit Binder from the North Carolina Court of Appeals will be made by "R." and "Ex. Bd.," respectively, followed by the page number. The Exhibit Binder contains the numerous exhibits attached to the five affidavits filed in the North Carolina trial court. The text of the affidavits can be found in the Record itself. When referring to a particular exhibit, the Guaranty Association will cite the beginning page of the affidavit in the Record, followed by the appropriate page in the Exhibit Binder.

[2]UNAC's deposit was registered as follows: "Treasurer of the State of North Carolina *in trust* for the Underwriters National Assurance Company and the State of North Carolina as their respective interests may appear under Article 20, Chapter 58-188.5 of the North Carolina Statutes." (Emphasis added.) (R. 23, Ex. Bd. 5)

Once made, the deposit became subject to North Carolina's comprehensive statutory regulation of the business of insurance. Among those statutes that are particularly relevant in demonstrating the legal nature of the UNAC deposit and its special status in protecting North Carolina policyholders are the following:

(1) N.C. Gen. Stat. § 58-188.5, which requires that the Treasurer of the State of North Carolina hold deposits made by insurance companies in trust; N.C. Gen. Stat. § 58-188.1(b), which allows the return of such deposits by the Trustee only after the insurance company has ceased to do business in North Carolina and has met all of its obligations; N.C. Gen. Stat. § 58-188.1(c), which states that actions to enforce the trust are to be brought in the Superior Court of Wake County, North Carolina; and N.C. Gen. Stat. § 58-185, which gives North Carolina policyholders a lien against the deposit made by an insolvent company to the extent of the insolvent company's defaulted obligations.

(2) N.C. Gen. Stat. §§ 58-155.10 to 58.155.17, which is North Carolina's enactment of the Uniform Insurers Liquidation Act ("Uniform Act"). The Uniform Act was promulgated and enacted in many states (but not in Indiana) because of the inapplicability of the Federal Bankruptcy Act. The Uniform Act deals both with the insolvency of a local insurance company and the insolvency of an insurer domiciled in another state but doing business locally. The purpose of the Uniform Act is to promote an orderly insolvency proceeding with regard to insurance companies doing business in a number of states. The Uniform Act is equally applicable to liquidation proceedings and rehabilitation proceedings. N.C. Gen. Stat. § 58-155.10(2). The Uniform Act recognizes the long-standing special status of deposits made by an insolvent insurer for the protection of policyholders in another state,

and requires that such deposits be used for the individuals for whose protection the deposit was made. N.C. Gen. Stat. §§ 58-155.10(10) and (11), 58-155.12(b), 58-155.15(c) and (d).

(3) N.C. Gen. Stat. §§ 58-155.65 to 155.84, which is North Carolina's enactment of the Life and Health Insurance Guaranty Association Model Act. The majority of states have now adopted the Model Act. (Indiana did so only subsequent to the insolvency of UNAC.) Under the North Carolina Life and Accident and Health Insurance Guaranty Association Act ("Guaranty Act"), all life, accident and health insurance companies doing business in North Carolina, whether domiciled in North Carolina or in another state, are required to become members of the North Carolina Life and Accident and Health Insurance Guaranty Association ("Guaranty Association"). N.C. Gen. Stat. § 58-155.70. When an insurance company domiciled in another state and doing business in North Carolina becomes insolvent, the Guaranty Association, through its members, must insure that the obligations owed by the insolvent insurer to North Carolina policyholders are met. N.C. Gen. Stat. § 58-155.72(4).

If the Indiana court were successful in denying use of the deposit for the sole benefit of North Carolina policyholders, the member insurers of the Guaranty Association would have to pay those obligations forgiven by the Indiana rehabilitation court. N.C. Gen. Stat. § 58-155.72(4). The solvent member companies of the Guaranty Association would be assessed an amount sufficient to pay those obligations. These assessments would result in an increased cost of doing business for the solvent companies and would be passed on to those companies' policyholders in the form of increased premiums, decreased dividends, and reduced benefits. UNAC, on the other

hand, would be allowed to retain the deposit that it placed in North Carolina for the protection of North Carolina policyholders.

To the extent that the Guaranty Association assumes the obligations owed by UNAC to North Carolina policyholders, those policyholders are deemed to have assigned their rights against the insolvent insurer to the Guaranty Association. N.C. Gen. Stat. § 58-155.72(9). Additionally, the Guaranty Act states that the Guaranty Association shall be subrogated to the rights assigned to it as against the assets of UNAC, and that the subrogation rights shall have the same priority against the assets of UNAC as those possessed by the policyholders. *Id.* Under the Guaranty Act, the obligation of the Guaranty Association to policyholders, and the Guaranty Association's assignment and subrogation rights, do not arise until after the *final order* of liquidation, rehabilitation or conservation. N.C. Gen. Stat. §§ 58-155.69(6), 58-155.72(4).

The Commissioner of Insurance and the Treasurer of the State of North Carolina, who are charged with the administration of the deposit and who held title to the deposit, join with the Guaranty Association as respondents in this matter in seeking to have the deposit used in accordance with the North Carolina statutes.[3]

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[3]UNAC states at page 4 of its brief that neither of these respondents have any interest in the dispute except as stakeholders. As stated by the Court below, under North Carolina law, ". . . the *title* and *rights* to securities . . . are vested in the Commissioner of Insurance, the Treasurer and the State." (Pet. App. 15A) The Commissioner of Insurance is charged with seeing that the laws of the State of North Carolina governing insurance companies are faifthfully executed. N.C. Gen. Stat. § 58-9(1). It is undisputed that the Treasurer has at all times since 1973 held the deposit made by UNAC in trust. "A trustee is not a mere stake holder. Upon him is imposed the duty of defending

The Indiana Insolvency Proceeding. On August 5, 1974, the Indiana Department of Insurance initiated an insolvency proceeding against UNAC. In response to the petition filed by the Indiana Department of Insurance, the Marion County Superior Court ordered the Commissioner of the Indiana Department of Insurance to take possession of the business and assets of UNAC and to conduct the business in such a way as to rehabilitate UNAC.

UNAC's financial problems were largely due to its improper underwriting of a large block of disability income insurance policies covering high income professional groups such as airline pilots, air traffic controllers and doctors. UNAC's disability income insurance policies were "noncancelable." (J.A. 59-66)[4] This noncancelable feature meant that the policies were renewable by the policyholder year after year at the same premium rate regardless of experience with that policyholder and regardless of the policyholder's increasing age. Thus, the policyholder was assured of having income protection at a fixed cost through most or all of the policyholder's income-producing years. Many of UNAC's disability insurance policies also contained a return of premium rider ("RPR"). The RPR, for which there was an additional premium charge, generally provided that, if no claim was made under the policyholder's basic disability insurance coverage for a period of 10 years, 80 percent of the premiums paid during that 10-year period would be returned to the policyholder. (R. 23, Ex. Bd. 9) The RPR

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the trust and preserving its assets . . . ." *In Re Trust Deeds of Smaltz,* 142 Pa. Super. 463, 466, 17 A.2d 455, 457 (1941) (citations omitted). *See State v. Dudley,* 127 N.J.L. 127, 129-30 21. A.2d 209, 210 (1941).

[4]References to the Joint Appendix will be made by "J.A." followed by the page number.

further provided that if claims were made during the 10-year period (less the claims paid by the company) would be returned to the policyholder. UNAC's liability to pay disability claims and RPR claims required substantial reserves that could not be raised by simply increasing the premiums on outstanding policies.

The Plan of Rehabilitation ("Plan") approved by the Indiana rehabilitation court on November 22, 1976, substantially reduced UNAC's need for reserves by cancelling obligations owed by UNAC to policyholders. The Plan converted noncancelable policies to "guaranteed renewable" policies. (J.A. 57) Under a guaranteed renewable policy, the policyholder has the option of renewing the policy, but the company has the option of increasing the premium. Thus, what were fixed premiums prior to UNAC's insolvency were subject to substantial increases after the rehabilitation. The Plan also eliminated UNAC's liability under the RPR. (J.A. 57) In return for his loss of rights under the RPR provisions, the policyholder received a nominal cash payment equal to 15.68 percent of the additional premium paid for the RPR. Thus, in return for a partial refund of the additional cost of the RPR, the policyholder lost the right to repayment of as much as 80 percent of his entire policy premium.

Absent use of the deposit made by UNAC in North Carolina for its intended purpose, the Guaranty Association would be obligated under the Guaranty Act to pay the amounts by which the premiums were increased pursuant to the Plan. The Guaranty Association would also be obligated to pay the policyholders in North Carolina the amounts to which they would have been entitled to under the RPR. N.C. Gen. Stat. § 58-155.72(4).

On June 8, 1976, the Guaranty Association, in conjuction with the guaranty associations of seven other states, intervened in the Indiana rehabilitation proceeding. (R. 30, Ex. Bd. 98) The concerted action on the part of the eight guaranty associations was precipitated by the fact that the proposed plan did not recognize the statutory assignment of policyholder rights to the guaranty associations under the various guaranty acts. (R. 30, Ex. Bd. 98) The Plan was ultimately altered to recognize those rights. (J.A. 57, 73) The guaranty associations also participated in the rehabilitation proceeding by negotiating a service contract between the guaranty associations and UNAC. (J.A. 27, 89)

As UNAC's brief carefully points out, both the North Carolina policyholders and the Guaranty Association were notified of the Indiana rehabilitation proceeding. However, at no point during the Indiana proceeding were North Carolina policyholders apprised by the rehabilitator or by the Indiana court of the existence of the deposit made in North Carolina for their protection or of their rights under North Carolina statutes in that deposit. The North Carolina policyholders were included in a single class along with all other policyholders. (J.A. 15, R. 30, Ex. Bd. 106) To the extent that the North Carolina deposit was considered a general asset, other policyholders in the single policyholder class would benefit and North Carolina policyholders would suffer. Thus, the North Carolina policyholders were included in a class in which there was a direct conflict of interest among class members without being apprised of that conflict or of facts sufficient to determine the conflict for themselves. Similarly, neither the rehabilitator nor the Indiana court ever informed the Guaranty Association of the existence of the deposit or that the deposit was purportedly part of the $31,171,998.00 shown in the Plan as general assets of UNAC. (J.A. 66)

UNAC's discussion of its convention blank is, at best, incomplete. The facts omitted in UNAC's discussion readily reveal that the rehabilitation court was probably misled by the convention blank as to the nature of the deposit held in North Carolina.

At page 10 of its brief, UNAC notes that insurance companies are required by the law of every state to file annual financial information with the Insurance Department of each state in which the company does business. UNAC correctly points out that the financial information is required to be presented in a uniform format called an "annual statement" or "convention blank," which is prescribed by the National Association of Insurance Commissioners. *E.g.*, Ind. Code § 27-1-3-13 and N.C. Gen. Stat. § 58-21. UNAC then correctly states that the convention blank requires a separate listing of the insurance deposits in each state and an itemized listing of all portfolio securities. Finally, UNAC notes that the total value of the portfolio securities is carried forward to the assets column of the insurer's balance sheet on the convention blank. UNAC then states at page 11 of its brief:

> The net of this is that UNAC's North Carolina deposit – together with all other deposits, was included in all calculations of the company's liquidation value, etc., in the formulation of the proposed plan, just as any other asset of UNAC, and any policyholder eventually electing to receive liquidation value received a check that included his proportionate share of the North Carolina bond along with everything else.

Prior to filing its Brief for the Petitioner in this Court, UNAC never before mentioned this convention blank in any of the proceedings involving the deposit made in North Carolina. The convention blank is clearly not part of the record below.

In discussing a document that is not part of the record, UNAC has apparently adopted the theory that the convention blank is a public document and, accordingly, is a matter of general knowledge to which this Court should give judicial cognizance. *Muller v. Oregon*, 208 U.S. 412, 421 (1908) This Court should have before it several other facts regarding UNAC's convention statement.[5]

The Convention statement filed by UNAC for the year ending December 31, 1974 – the year during which UNAC was determined to be insolvent – contained the following statement from the Commissioner of Insurance of Indiana:

> As previously advised, Underwriters National Assurance Company was placed in the hands of the Indiana Department of Insurance by order of Rehabilitation entered by Marion County Superior Court on August 5, 1974. For this reason there is no list of officers nor directors in the annual statement. This statement was compiled under the direct supervision of the Indiana Department of Insurance and reflects the financial condition of the company as of December 31, 1974.
>
> In October of 1974 we employed the actuarial firm of Milliman & Robertson to make a complete study of the company. We have also employed the certified public accountant firm of Coopers & Lybrand to do an audit of the com-

[5]A reproduction of the relevant portions of the covention statement for the year ending December 31, 1974, filed by UNAC appears in the Appendix to this brief at page 1-B. Additionally, certified copies of the relevant portions of UNAC's 1973, 1974, and 1975 convention blanks have been lodged with the Clerk for the convenience of this Court.

> pany. Based upon these reports and other information which we have generated, a decision about the future of the company will be made in the immediate future. When such determination has been made it will be communicated to the interested regulatory agencies.
>
> Lloyd M. Allen
> Commissioner

Based on the above statement it is apparent that the information set out in the convention blank is the same information presented to the rehabilitation court for use in restructuring UNAC.

In discussing the convention blank, UNAC states at page 10 of its brief that "Deposits are listed on page 18 of the convention blank under a schedule requiring listing of all deposits made with any Government, Province, State, District, County, Municipality, Corporation, firm or individual . . ." UNAC fails to quote to this Court the entire caption for the schedule to which it was referring. The entire caption is as follows: 'SCHEDULE OF ALL *OTHER* DEPOSITS Showing all deposits made with any Government, Province, State, District, County, Municipality, Corporation, firm or individual, *except* those shown in Schedule in Schedule E, and *those shown in 'Special Deposit Schedule' above."* (Emphasis added.) Thus, the schedule to which UNAC refers is the schedule showing *general* deposits made for the benefit of *all* policyholders. UNAC correctly states that the deposit made by UNAC in North Carolina is shown in that general deposit schedule, despite the fact that it was a special deposit for the benefit of North Carolina policyholders only.

UNAC has also omitted any reference to the other schedule shown on page 18 of the convention blank. That other schedule is captioned as follows: "SPECIAL

DEPOSIT SCHEDULE *Showing all deposits or investments NOT held for the protection of ALL the policyholders of the Company.*" (Emphasis added) Thus, the schedule on page 18 of the convention blank to which UNAC does not refer is the schedule requiring a listing of deposits, such as the one made in North Carolina, held for the benefit of a specific group of policyholders. Under that schedule in UNAC's convention blank the only entry is the single word "NONE."

The deposit made by UNAC in North Carolina was clearly for the protection of only North Carolina policyholders and should have been listed under the special deposit schedule rather than under the schedule showing deposits held for the benefit of all policyholders. Accordingly, the document filed with the North Carolina Department of Insurance and with the rehabilitation court in Indiana falsely characterized the North Carolina deposit as a deposit for the benefit of all policyholders.

The 1975 convention blank filed by UNAC with the North Carolina Department of Insurance also falsely states that there are no special deposits and that the deposit made in North Carolina was for the benefit of all policyholders of UNAC. The 1975 convention blank was filed in North Carolina on March 1, 1976, only a matter of months before the Plan was approved by the Rehabilitation Court. Thus, the rehabilitation court had apparently been led throughout the proceeding by the rehabilitator to believe that the North Carolina deposit was held for the benefit of all policyholders.

None of the convention blanks filed by UNAC in North Carolina reflect total assets equal to the $31,171,988 amount mentioned in the rehabilitation proceeding. Thus, even if the nature of the deposit had not been

misrepresented, the convention blanks could not be reasonably deemed to have put anyone on notice that the Indiana rehabilitation proceeding purportedly dealt with rights in the North Carolina deposit. The North Carolina policyholders and the Guaranty Association simply had no way of knowing their statutory rights were purportedly being abrogated.

At page 30 of its brief, UNAC again discusses the 1974 convention blank filed by the rehabilitator. UNAC states that the convention blank disclosed a deposit made in Virginia. UNAC's brief seems to imply that a special class of policyholders was created by the appearance of a single Virginia policyholder who supposedly could have represented the interests of both Virginia and North Carolina policyholders in their respective deposits. This is certainly not the case. The Virginia deposit, like the North Carolina deposit, was held for the benefit of local policyholders only. Va. Code § 381-110. However, like the North Carolina deposit, the Virginia deposit was shown on the convention blank as a deposit for the benefit of *all* policyholders of UNAC. Had the Virginia policyholders known of the convention blank, they would have been misled as to the nature of the deposit. Further, there is absolutely nothing in the record to indicate that the Virginia policyholders were apprised of the existence of the deposit made in Virginia or of their special rights therein. Thus, they could have represented neither their interests nor anyone else's with regard to a special deposit. Apparently, to this day, the Virginia policyholders are unaware of the existence of the deposit made for their protection or of their rights therein.

On November 22, 1976, the Indiana rehabilitation court issued its Final Judgment and the Plan. (J.A. 37) The Final Judgment recited that the rehabilitation court

had jurisdiction over all policyholders and over the eight guaranty associations involved (J.A. 38). The Final Judgment held: "To the extent that any claim, objection or proposal which was or *could have been presented* in this rehabilitation proceeding is inconsistent with the Plan, that claim, objection or proposal is overruled and relief to that extent denied." (Emphasis added.) (J.A. 40) The court does not explain how a claim "could have been presented" regarding the deposit when no policyholder knew of the existence of the deposit or could have reasonably anticipated that the court would attempt to abrogate statutory rights therein.

The Final Judgment also provided that the Indiana rehabilitation court would retain continuing jurisdiction over the parties and over the rehabilitation proceeding to resolve questions as to interpretation and implementation of the Plan and to modify the Plan as needed in light of future developments. (J.A. 42-43) At page 12 of its brief, UNAC quotes from the Plan as follows: "UNAC shall have no further obligation or liability to any guaranty association." UNAC's brief quotes only the first clause of that sentence. The first two clauses of the quoted sentence are: "UNAC shall have no further obligation or liability to any guaranty association, *other than* the obligation to recognize as valid the assignment of the policyowner's rights to the Guaranty Association and to treat the Guaranty Association as it would have treated the policyowner; . . . ." (emphasis added.) (J.A. 74) Copies of the Plan and the Final Judgment of the Indiana rehabilitation court were not mailed to policyholders, shareholders, insurance comissioners, agents and other interested parties until June of 1977. (R. 30, Ex. Bd. 292)

On June 8, 1977, a joint petition was filed with the Indiana rehabilitation court by UNAC and the eight

guaranty associations. (J.A. 89) The joint petition sought permission from the rehabilitation court to enter into a service contract. On June 14, 1977, the Indiana rehabilitation court issued an order stating ". . . that the Company and each of the Guaranty Associations are authorized and directed to execute a Service Contract in substantially the form attached to the Petition as Exhibit A and to do all acts reasonably necessary or appropriate to implement and carry out the Service Contract." (R. 30, Ex. Bd. 291) Under the Service Contract UNAC would continue to administer the insurance policies of policyholders residing in guaranty association states in accordance with the pre-rehabilitation terms of those policies. That is, UNAC would continue to honor the pre-rehabilitation RPR obligations owed to policyholders and would continue to charge the pre-rehabilitation guaranteed, fixed premium. The guaranty associations would pay to UNAC amounts equal to the RPR obligations paid and the increased premiums chargeable as a result of the rehabilitation proceeding. The Guaranty Association would also pay to UNAC a fee for administering the policies in accordance with the pre-rehabilitation terms of those policies.

On October 13, 1977, the Guaranty Association signed the Service Contract in substantially the same form as that approved by the Indiana rehabilitation court. The Service Contract signed by the Guaranty Association differed from the form approved by the Indiana rehabilitation court only to the extent that it contained the following language:

> It is expressly agreed, however, that the Guaranty Association and Underwriters explicitly reserve all their rights and remedies in connection with any deposits made by Underwriters

> with the Commissioner of Insurance of North Carolina, including deposits understood to total One Hundred Thousand Dollars ($100,000.00), which rights and remedies are governed by North Carolina law.

(R.23, Ex. Bd. 34) By letter dated December 5, 1977, Underwriters forwarded to the Guaranty Association a fully executed copy of the Service Contract. In its December 5, 1977 letter UNAC stated:

> Enclosed is a signed copy of the Service Agreement between Underwriters National Assurance Company and North Carolina Life and [sic] Health Insurance Guaranty Association. As you know, this agreement is entered into pursuant to the Plan of Rehabilitation of UNAC that has been approved by the Indiana courts.
>
> The purpose of this letter is to set forth UNAC's understanding that the last paragraph in the form of agreement beginning "It is expressly agreed, however," is designed simply to recite that neither the Guaranty Association nor UNAC has waived any claims that it may have in connection with the North Carolina deposits. You should understand that UNAC takes the position that the Guaranty Association has no claims to the deposits. In particular, UNAC's Plan of Rehabilitation had the effect of shutting off rights that North Carolina citizens and/or the Guaranty Association might otherwise have had to the deposits. That Plan has been approved by the Indiana courts and, as a matter of full faith and credit under the federal constitution, is now binding under North Carolina law as well. Please advise us if the Guaranty Association has any

> different view. As we understand it, the last paragraph was inserted by the Guaranty Association simply to preserve whatever rights it may have had after the implementation of the Plan, and we have executed the enclosed agreement and returned it to you with that understanding.

Thank you for your cooperation.

(R. 23, Ex. Bd. 35)

It was at this point that the Guaranty Association first learned that UNAC would take the position that the rehabilitation proceeding purported to affect the rights of North Carolina policyholders under North Carolina statutes in the deposit placed in North Carolina for the protection of local policyholders.

Post-Rehabilitation Proceedings In North Carolina And Indiana. On January 12, 1978, the Guaranty Association initiated a declaratory judgment action in the Wake County North Carolina, Superior Court. The defendants named were UNAC, the North Carolina Commissioner of Insurance, and the Treasurer of the State of North Carolina. (R. 3) The action filed by the Guaranty Association in North Carolina sought a judgment declaring the Guaranty Association's right to have the deposit made by UNAC in North Carolina used to pay the contractual obligations owed by UNAC to North Carolina policyholders. The North Carolina Commissioner of Insurance and Treasurer filed a cross-claim against UNAC requesting that the deposit made by UNAC be liquidated for the benefit of the Guaranty Association and North Carolina policyholders. (R. 8)[6] UNAC's answer and counterclaim

[6]UNAC's characterization at page 15 of its brief of the North Carolina Insurance Commissioner and the Treasurer as "nominal defendants," is incorrect. See footnote 3, *supra*.

filed in the North Carolina proceeding, while raising the constitutional issue of full faith and credit, made no claim that the relief sought in the North Carolina court would amount to an unconstitutional burden on interstate commerce.

In response to the suit filed in North Carolina, UNAC filed a Petition for Instructions on July 13, 1978, with the Indiana rehabilitation court. (J.A. 111) One of the matters with regard to which UNAC requested instructions was how to proceed under the Service Contract between UNAC and the Guaranty Association in light of the suit filed by the Guaranty Association in North Carolina. (J.A. 117-120) A hearing with regard to that question was held by the Indiana rehabilitation court on September 20, 1978. Both the Guaranty Association and UNAC appeared at that hearing and asserted their respective full faith and credit claims. (Pet. App. 31A-32A) The Indiana court ruled at the conclusion of the September 20, 1978 hearing that no rehabilitation rights in the deposit made by UNAC in North Carolina survived the rehabilitation proceeding. The court's ruling was embodied in a written order dated November 22, 1978 which stated, in part:

> 2. The Court's final Order and the Plan fully adjudicated and determined that the North Carolina deposit was an asset of (and its use was to be determined by) the rehabilitated Underwriters, and any claim existing as of the date of adoption of the Plan against the deposit by the North Carolina Association or by any policyowner or creditor of Underwriters was compromised, settled and dismissed by the final Order and the Plan.

(Pet. App. 31A, 38A)

As indicated by the quoted portion of the Order above, the September 20, 1978 hearing was not a *de novo* hearing with regard to the issue of whether the rehabilitation court had jurisdiction to abrogate the statutory rights of North Carolina policyholders in the deposit located in North Carolina. The Indiana court, without ever mentioning jurisdiction, simply concluded that the earlier rehabilitation proceeding cut off policyholder rights North Carolina statutes in the deposit. The order of the Indiana court was issued more than ten months after the initiation of the North Carolina proceeding. The November 22, 1978 Order was appealed by the Guaranty Association to the Indiana Court of Appeals. The issues on appeal in Indiana are whether the Indiana court possessed the necessary jurisdiction to adjudicate rights in the deposit in North Carolina and whether, assuming jurisdiction, ". . . the Full Faith and Credit provision of the United States Constitution . . . would require the [Indiana] Court to honor the statutory rights of North Carolina policyholders." Brief of Appellant, *North Carolina Guaranty Association v. Department of Insurance, State of Indiana,* Indiana Court of Appeals, No. 2-1278A435. The case has been fully briefed and oral arguments have been heard. The Indiana Court of Appeals has stayed its consideration pending disposition by this Court of this certiorari proceeding.

On March 19, 1979, the North Carolina Superior Court held a hearing on motions for summary judgments filed by all parties in the North Carolina proceeding. (Pet. App. 19A) The parties agreed that no material facts were at issue. Affidavits and briefs were submitted by both UNAC and the Guaranty Association. The issues of whether the Indiana rehabilitation court had sufficient jurisdiction to deal with the deposit made in North Carolina, and

whether it did so, were fully argued before the North Carolina court. On April 11, 1979, the North Carolina trial court entered an order holding that the deposit made by UNAC in North Carolina should be applied for the benefit of North Carolina policyholders and the Guaranty Association. (Pet. App. 19A)

UNAC appealed the decision of the North Carolina Superior Court to the North Carolina Court of Appeals. While UNAC did raise the constitutional issue of full faith and credit, it did not assert that the holding of the North Carolina court below was an unconstitutional burden on interstate commerce. By opinion dated September 2, 1980, the North Carolina Court of Appeals unanimously affirmed the decision of the North Carolina Superior Court. (Pet. App. 5A) In affirming the decision of the North Carolina Superior Court, the North Carolina Court of Appeals held, in part:

> It is undisputed that the deposit made by UNAC is located in North Carolina and is held in trust. It is the manifest intention of the North Carolina Legislature that the *title* and *rights* to securities deposited in accord with Article 20, Chapter 58-188.5 *et seq.* are vested in the Commissioner of Insurance, the Treasurer and the State. *Continental Bank and Trust Co. v. Gold,* 140 F. Supp. 252 (E.D.N.C. 1956). The Indiana Court did not have the necessary personal jurisdiction over the Commissioner of Insurance and the Treasurer. Since UNAC did not hold title to the deposit, it was not an asset of the company subject to the Indiana rehabilitation proceeding. Thus, neither the trust property nor the Commissioner and Treasurer were subject to the judicial jurisdiction of the Court in Indiana. Because the

> Indiana court lacked jurisdiction of the subject matter and in personam jurisdiction to determine the statutory rights of the North Carolina policyholders in the deposit made by UNAC, the Indiana Court's decision is not entitled to full faith and credit in North Carolina and is not protected by the doctrine of *res judicata.*

(Pet. App. 15A) The North Carolina Supreme Court entered a judgment dismissing UNAC's appeal and denying UNAC's petition for discretionary review.

A chronology summarizing the events occurring in Indiana and North Carolina is set out beginning at page 1-A of the Appendix and is intended to assist this Court in sorting out the facts discussed in the Petitioner's and Respondents' brief.

SUMMARY OF ARGUMENT

The determination by the Indiana rehabilitation court that the North Carolina special deposit was a general asset of UNAC has no jurisdictional basis and, thus, is not entitled to full faith and credit in North Carolina. To require that full faith and credit be accorded to that determination would not further unify the states into a federal system, but divide them. Every state's efforts to regulate the conduct of foreign insurers and protect policyholders within its borders would be put at the mercy of the states where those insurers are domiciled.

The Indiana court clearly acted outside its jurisdiction, in abrogating statutory rights of North Carolina policyholder in the special deposit placed in trust in, North Carolina for their protection. First, it is undisputed that the Indiana court lacked jurisdiction over the North Carolina officials who

are trustees of the special deposit. The North Carolina trustees were necessary parties to any adjudication of rights in the deposit since their interest, and the interest of North Carolina, was in seeing that the State's statutory policy was followed in the distribution of the special deposit. The Indiana court thus lacked authority under both North Carolina law and Indiana law for its adjudication that the special deposit was a general asset of UNAC. Second, the jurisdictional claims of the Indiana court to adjudicate rights of the North Carolina policyholders cannot extend to this adjudication. In addition to being both unfair to the North Carolina policyholders and an affront to the sovereignty of North Carolina, the assertion of jurisdiction by the Indiana court to deal with the statutory rights of those policyholders proves defective, whether subjected to a minimum contacts analysis or a jurisdictional necessity analysis. It does not appear that the Indiana court even considered these objections to its assertion of jurisdiction to adjudicate rights in the North Carolina special deposit.

Further, the North Carolina policyholders were never apprised by the Indiana court of the existence of the North Carolina deposit, of their statutory rights in that deposit or of the Indiana court's intent to adjudicate rights in that deposit. While the North Carolina policyholders were notified that a rehabilitation proceeding was underway, they had no reasonable way of knowing that their rights in the special deposit would be adjudicated in that proceeding. Indeed, it is unlikely that the Indiana court would have even attempted to adjudicate rights in the North Carolina deposit had it not been misled by UNAC's convention blank as to the nature of that deposit.

Finally, North Carolina cannot be asked to accord full faith and credit to a judgment so inimical to the laws and

interests of North Carolina. The federal system would not be advanced but severely strained by such a requirement. This is not a case where the strong policies of two States collide headlong. Rather, this is a case where the strong policies of one State – policies that have been widely adopted in other states and consistently upheld by the courts – are undone by a haphazard and uncomprehending proceeding in another. North Carolina law should clearly prevail.

ARGUMENT

The North Carolina Court of Appeals has declared that UNAC's $100,000 deposit in North Carolina should be liquidated as intended for the sole benefit of North Carolina policyholders. That decision is consistent with universal principles of insurance law and trust law and North Carolina statutes governing deposits. That decision also reflects legitimate North Carolina concerns that policyholders residing in that State be fully protected when their insurance carriers become financially disabled from their obligations. To assure that its laws govern, North Carolina has retained for itself all significant jurisdictional contacts – including both legal title and actual possession of the deposit – to adjudicate any question concerning the special deposit. The Indiana court's inclusion of the special deposit in the plan of rehabilitation as a general asset of UNAC, in abrogation of North Carolina statutes, cannot command full faith and credit in North Carolina.

I. THE INDIANA REHABILITATION COURT LACKED JURISDICTION TO ADJUDICATE RIGHTS IN THE DEPOSIT HELD IN TRUST IN NORTH CAROLINA.

This Court has consistently held in a variety of contexts that the decision in one court is conclusive upon the merits under the Full Faith and Credit Clause in a court in another state "only if the court in the first State had power to pass on the merits – had jurisdiction, that is, to render the judgment." *Durfee v. Duke,* 375 U.S. 106, 110 (1963). As recently reiterated in *Nevada v. Hall,* 440 U.S. 410, 421 (1979), "[t]he Full Faith and Credit Clause does require each State to give effect to official acts of other States. A judgment entered in one State must be respected in another *provided that the first State had jurisdiction over the parties and the subject matter."* (Emphasis added.)

That critical proviso has not been satisfied in this case. The Indiana rehabilitation court did not have jurisdiction over the North Carolina parties possessing legal claims to the North Carolina trust deposit. Nor did the Indiana court have jurisdiction over the trust deposit itself. The Indiana court did not fully and fairly adjudicate issues of jurisdiction; therefore, the North Carolina courts correctly determined that the Indiana court lacked such jurisdiction that the Full Faith and Credit Clause would require the Indiana decision be given *res judicata* effect. Indeed, Indiana's attempt to decide questioned rights in the North Carolina deposit is so unfair to the North Carolina policyholders and such an affront to the legitimate North Carolina policies and interests embodied in the deposit that it implicates the Due Process Clause of the Fourteenth Amendment. *See World-Wide Volkswagen Corp. v. Woodson,* 444 U.S. 286, 291-294 (1980). Under these circumstances the Indiana judgment was not entitled to full faith and credit in North Carolina.

A. The Indiana Court Lacked Jurisdiction Over Either The Trust Corpus Or The Trustees.

UNAC does not question the holding of the North Carolina Court of Appeals that under North Carolina statutes the special deposit required of UNAC was held in trust in North Carolina with the North Carolina Treasurer and Commissioner of Insurance as trustees for the sole benefit of North Carolina policyholders. Nor does UNAC question the holding that the Indiana court lacked jurisdiction over these North Carolina officials. Rather, UNAC's position is that the lack of jurisprudiction over these North Carolina officials makes no difference since neither held any beneficial interest in the special deposit. UNAC argues that the Indiana court had jurisdiction over the beneficiaries of the trust, and could therefore adjudicate the claims of those beneficiaries. The legal title would be undisturbed, at least for the moment.

The North Carolina Court of Appeals correctly stated the rule that a court cannot consider an action concerning a trust without jurisdiction over either the trustee or the trust corpus. While this rule may not be one imposed by the Constitution, *Hanson v. Denckla,* 357 U.S. 235, 254 (1958), it is undoubtedly the general rule, *e.g.,* W. LAND, TRUSTS IN THE CONFLICT OF LAWS, 257 (1940) ("If . . . neither the trust property nor the trustee is subject to the judicial jurisdiction of the state, the court has no jurisdiction over the trust . . . ."); 76 Am.Jur.2d, *Trusts* § 572, at 783-84 (1975); Annot., *Jurisdiction of Suit Involving Trust as Affected by Location of Res, Residence of Parties to Trust, Service, and Appearance,* 15 A.L.R.2d 610 (1951), and the rule followed in Indiana. Under Indiana common law, a judgment against a trust was void if the court had no jurisdiction over the corpus of the trust. *See*

Premier Steel Co. v. Yandes, 139 Ind. 307, 315-16, 38 N.E. 849 852 (1894). Other cases have allowed Indiana courts of equity to adjudicate questions concerning a trust where the corpus was located in another state by exercising jurisdiction the trustee. *See Sturdevant v. Pike,* 1 Ind. 277, 279 (1848). It is clear, however, that Indiana law contemplates that a court exercising jurisdiction to determine rights in a trust must have before it either the trustee or the corpus. *See* Ind. Code § 30-4-6-3 (venue). *See also Newlin v. Newlin,* 114 Ind. App. 574, 581, 52 N.E.2d 503, 505 (1944).

The analysis of jurisdiction in a matter involving a trust must begin with this Court's decision in *Hanson v. Denckla,* 357 U.S. 235. In *Hanson,* a Florida probate court had declared a Delaware trust to be illusory. Florida law, however, made the trustee an indispensable party to an action questioning the validity of a trust. Because the Florida court did not have jurisdiction over the Delaware trustee, this Court held, the Delaware court was not bound by the Florida judgment. "Since Delaware was entitled to conclude that Florida law made the trust company an indispensible party," the Court said, "it was under no obligation to give the Florida judgment any faith and credit – even against parties over whom Florida's jurisdiction was unquestioned." *Id.* at 256. North Carolina was similarly entitled to conclude, therefore, that the Indiana rehabilitation court did not have authority under Indiana law for its adjudication that the North Carolina special deposit was a general asset of UNAC.

It was not just Indiana law, however, that made the North Carolina trustees indispensable: it was also North Carolina law. It is not the case here that the North Carolina officials are nominal parties with no interest in the deposit.[7] Their interest is the interest of North

[7]See footnote 3, *supra.*

Carolina. North Carolina required that the special deposit be placed in trust as a part of its comprehensive statutory scheme for the regulation of insurance. North Carolina officials serve in their official capacities as trustees of the special deposit. UNAC is undoubtedly correct that the effect of the decision below is to make these North Carolina officials "indispensable but unreachable parties." (UNAC Brief at 33). That is exactly what North Carolina law intends. If North Carolina is to give effect to its laws governing the distribution of the special deposit, it must give to its courts the exclusive jurisdiction to adjudicate questions concerning the deposit. Requiring UNAC to sue in North Carolina to have rights in the deposit adjudicated places no unreasonable burden on UNAC.

This Court has recognized just such exclusive jurisdiction in each State to control the administration of real estate located within its borders. In *Clarke v. Clarke*, 178 U.S. 189 (1900), and again in *Fall v. Eastin*, 215 U.S. 1 (1909), the Court held that a state court decree purporting to convey land located in another state was without extraterritorial effect, even though in both cases all claimants to the land had been before the Court granting the decree. It was the interest of the State itself in the land located within its borders that required that the decrees not be recognized:

> Of what efficacy . . . would be the power of one State to control the administration, through its own courts, of real estate within the State . . . if all such real estate could be disposed of and controlled by the decree of the court of another State. Here, again, the argument relied on must rest upon the false assumption that an exclusive power which confessedly exists in the courts of one jurisdiction may be rendered nugatory by the action of the courts of another jurisdiction in

> whom is vested no authority whatever on the subject.

Clarke v. Clarke, 178 U.S. at 194.

North Carolina has similar interests in exercising exclusive jurisdiction to determine rights in the North Carolina special deposit. The legitimacy of such special deposits for the protection of local policyholders is well established. The North Carolina Supreme Court has very recently addressed the nature and purpose of these deposits:

> Deposits pursuant to Article 20 [of the North Carolina Statutes] constitute a *trust* for the benefit of North Carolina policyholders and are not *assets* of the insolvent insurance company. *Continental Bank & Trust Co. v. Gold*, 140 F. Supp. 252 (E.D.N.C. 1956); 2 Couch on Insurance §§ 22:94, 22:96, 22:111 (2d Ed. 1959); 19 Appleman, Insurance Law and Practice § 11094 (1979 Supp.); *see also Guaranty Association v. Assurance Co.*, 48 N.C. App. 508, 269 S.E.2d 688, *cert. den.*, 301 N.C. 527, 273 S.E.2d 453 (1980), *cert. granted*, ____ U.S. ____, 68 L.Ed.2d 838, ____ S.Ct. ____ (1981). Such deposits supplement the general corporate law which does little to protect claimants and policyholders of insolvent insurers.

North Carolina v. Reserve Insurance Co., No. 113, slip op. at 8 (N.C. Supreme Court, decision filed August 17, 1981) (emphasis in original). The opinion in *Reserve* is included in the Appendix to this brief beginning at page 1-C.

UNAC's entire argument is based upon the proposition that the North Carolina deposit is a general asset of

UNAC. That is clearly not the law in North Carolina. As the North Carolina Supreme Court said in *North Carolina v. Reserve Insurance Co.*: "Special deposits are not general assets." *Id.* at 14.

This Court has also recognized that a special deposit of this type is legally "segregated from the mass of property owned by the [foreign insurance] company:"

> It may be appropriate to observe that the objections to the statute in Tennessee do not necessarily embrace enactments that are found in some of the States requiring foreign insurance corporations, as a condition of their coming into the state for purposes of business, to deposit with the state treasurer funds sufficient to secure policyholders in its midst. Legislation of that character does not present any question of discrimination against citizens forbidden by the Constitution. *Insurance funds set apart in advance for the benefit of home policyholders of a foreign insurance company doing business in the State are a trust fund of a specific kind to be administered for the exclusive benefit of certain persons. Policyholders in other States know that those particular funds are segregated from the mass of property owned by the company, and that they cannot look to them to the prejudice of those for whose special benefit they were deposited.*

Blake v. McClung, 172 U.S. 239, 257 (1898) (emphasis added) (*dictum*).[8]

[8]North Carolina first passed statutes governing such deposits made by foreign insurers one year after this Court's decision in *Blake v. McClung* approved of them. *See*, 1899 N.C. Sess. Laws, Ch. 54, s. 17.

The commentators on insurance law have also consistently recognized that such deposits enjoy a special status. UNAC quotes *Couch on Insurance* for the proposition that an insurance company insolvency is a matter of general public concern. (Brief at 21) UNAC does not quote other passages from that treatise specifically approving the role of special deposits in meeting that concern:

> A deposit of securities made by a foreign insurance company with the state superintendent of insurance constitutes a trust fund for the benefit of local policyholders and bond obligees and under the statutory provisions relative to such deposit the superintendent owes no duty to the state superintendent of insurance of the domicile of the company acting as liquidator of the same until he is satisfied upon examination of the books of the company and affidavits of its principal officers and other evidence that all the obligations and liabilities which the deposit was made to secure have first been paid or extinguished.

2 *Couch on Insurance,* § 22:96 (2d ed. 1959); *see also,* §§ 22:94, 22:111, *Accord,* Joyce, *Law of Insurance* § 3595 (2d ed. 1918) ("A deposit with a state treasurer of securities as a guaranty for the payment of policies of an insurance company, whether made as a statutory requirement or voluntarily, . . . creates a trust for the benefit of such policyholders in case of the insolvency of the company."); 19 Appleman, *Insurance Law and Practice* § 11094 (2d ed. 1946); 43 Am.Jur. 2d, *Insurance* §§ 139, 140 (1969); and 44 C.J.S., *Insurance* § 134 (1945).

The decisions of state courts uniformly uphold the priority of local policyholders in deposits made by foreign

insurers for their benefit.[9] *See Vandiver v. Poe,* 119 Md. 348, 87 A. 410 (1913), where the court, in upholding the rights of local policyholders in a special deposit, said "there is hardly a break in the line of decisions to the effect that receivers and assignees are not entitled to demand the possession of such securities . . . ." *Id.* 87 A. at 413.[10]

North Carolina requires these special deposits as a condition to a foreign insurer conducting business in North Carolina. The legitimacy of a local policy that limits the conduct of business in this matter is well recognized. In *Clark v. Willard,* 292 U.S. 112 (1934), this Court considered the insolvency of an insurance company domiciled in Iowa and doing business in Montana. A domiciliary receiver was appointed in Iowa. In a suit against the company in Montana filed after the appointment of the receiver in Iowa, the Montana court concluded that creditors in Montana were at liberty to levy attachments and executions against the property of the insolvent insurance company in Montana. In reversing the decision of the Montana court, this Court said: "In thus holding, we do not say there is an invariable rule by which the title of the statutory liquidator must prevail over executions and attachments outside the state of his appointment." *Id.* at 122. This Court went on to hold that if there is a local

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[9]*Preferred Insurance Co. v. Bentley,* 223 Ga. 735, 157 S.E.2d 737 (1967); *Van Schaick v. Bowen,* 131 Ohio St. 310, 2 N.E.2d 824 (1936); *State v. American Bonding & Casualty Co.,* 206 Io. 988, 221 N.W. 585 (1928); *Maurer v. International Re-Insurance Corp.,* 20 Del. Ch. 173, 174 A. 360 (1934); *Boston & Alb. Railroad v. Mercantile Trust & Deposit Co.,* 82 Md. 535, 34 A. 778 (1896).

[10]*Accord, McMurray v. Commonwealth,* 249 Mass. 574, 144 N.E. 718 (1924); *Crowell v. Terrell,* 250 S.W. 252 (Tex. Civ. App. 1923); *Cooke v. Warner,* 56 Conn. 234, 14 A. 798 (1888); *In re Guardian Mutual Life Insurance Co.,* 13 Hun. 115 (N.Y.S. Ct. 1878); *Ruggles v. Chapman,* 59 N.Y. 163 (1874).

policy expressed in statute or by a decision allowing an unequal distribution of assets of a foreign insolvent corporation in favor of local creditors, that policy would prevail. North Carolina's enactment of deposit statutes and the Uniform Insurers Liquidation Act and the North Carolina case law, all of which give priority in special deposits to local policyholders, clearly express such a local policy. *E.g.*, N.C. Gen. Stat. §§ 58-155.10 to 58-155.17, 58-185; *Continental Bank & Trust Co. v. Gold,* 140 F. Supp. 252 (E.D.N.C. 1956).

State policies favoring local policyholders, as approved in *Clark v. Willard,* can be applied to an insurance company as a limitation on the company's right to transact insurance business in the State. In *Relfe v. Rundle,* 103 U.S. 222, 225-26 (1880), this Court said:

> No state need allow the corporations of other states to do business within its jurisdiction unless it chooses, with perhaps the exception of commercial corporations; but if it does, *without limitation, express or implied,* the corporation comes in as it has been created. Every corporation necessarily carries it charter wherever it goes, for that is the law of its existence. (Emphasis added.)

In recognizing that a state can apply limitations in allowing a foreign corporation to do business. *Relfe,* like *Clark v. Willard,* clearly indicated that a local policy allowing an unequal distribution of the assets of a foreign insolvent corporation in favor of local creditors would prevail.

Despite the overwhelming weight of authority recognizing the legitimacy of such deposits and embracing their unique legal status, the North Carolina law here would be rendered nugatory by the action of the Indiana rehabilitation court. North Carolina has retained all significant

jurisdictional contacts to assure that it would be solely responsible for the distribution of the special deposit. Its exclusive jurisdiction should be recognized.

UNAC deposited securities in trust in North Carolina to protect North Carolina policyholders in contemplation of the exact event that subsequently occurred. UNAC now takes the inequitable position that the deposit should not be used for its stated purpose of fulfilling the contractual obligations owed to North Carolina policyholders by the insolvent company. Rather, UNAC would have the solvent insurance companies doing business in North Carolina, through the assesments made on them by the Guaranty Association, pay the contractual obligations owed by UNAC to North Carolina policyholders. The assessed companies would be forced to recoup their losses by increasing premiums or decreasing benefits to other policyholders. Thus, other North Carolina policyholders, most of whom have probably never heard of UNAC, would ultimately pay for UNAC's defaults, and UNAC, the party at fault, would be allowed to keep the deposit that it made for the protection of its policyholders in North Carolina. This would not be equitable, and such a result certainly would not violate the Full Faith and Credit Clause.

B. The Indiana Court Lacked The Requisite Jurisdictional Contacts To Adjudicate Rights In The North Carolina Trust.

The Indiana rehabilitation court's claim to jurisdiction to adjudicate rights in the deposit by virtue of jurisdiction over the beneficiaries of the trust, the North Carolina policyholders, is flawed by the limited nature of that jurisdiction. The standard by which all assertions of state court jurisdiction are to be evaluated by the "minimum con-

tacts" standard first announced by this Court in *International Shoe Co. v. Washington*, 326 U.S. 310 (1945). *Shaffer v. Heitner*, 433 U.S. 186 (1977). The focus of inquiry under the *International Shoe* standard is whether the person over whom jurisdiction is asserted has such contacts "with the state of the forum as make it reasonable, in the context of our federal system of government, to require [the person] to defend the particular suit which is brought there." *International Shoe Co. v. Washington*, 326 U.S. at 317. The concept of minimum contacts, therefore, is intended to address two concerns that are present when a state court attempts to adjudicate the rights of nonresidents: "It protects the defendant against the burdens of litigating in a distant or incovenient forum. And it acts to ensure that the states through their courts, do not reach out beyond the limits imposed on them by their status as coequal sovereigns in a federal system." *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. at 292.

What is "reasonable," of course, largely depends on what is being adjudicated. A nonresident's activities within a forum state may make it reasonable for that state to adjudicate matters arising out of, or closely associated with, those activities, but not to consider any and all claims against that nonresident. *E.g., McGee v. International Life Insurance Co.*, 355 U.S. 220, 223 (1957) ("It is sufficient for purposes of due process that the suit was based on a contract which has a substantial connection with [the forum] State"); *see generally*, von Mehren & Trautman, *Jurisdiction to Adjudicate: A Suggested Analysis*, 79 Harv.L.Rev. 1121 (1966). Thus contacts are not to be considered in the abstract, but to establish "the relationship among the defendant, the forum, *and the litigation.*" *Shaffer v. Heitner*, 433 U.S. at 204 (emphasis added).

UNAC dwells in its brief on the jurisdiction of a rehabilitation court to modify in a uniform fashion the

contractual policy rights of all policyholders as part of an effort to save an insolvent insurer. That is not, however, the litigation here in question. The question before this Court is the jurisdiction of the Indiana court to determine, in abrogation of North Carolina statutes, that the special deposit held in trust in North Carolina was a general asset of UNAC.

Whatever jurisdiction the Indiana court had to modify policy rights in the context of a rehabilitation proceeding does not extend to include the determination of rights in the special deposit. UNAC relies heavily in its brief on this Court's decision in two cases – *Neblett v. Carpenter,* 305 U.S. 297 (1938), and *Mullane v. Central Hanover Bank & Trust Co.,* 339 U.S. 306 (1950) – allowing jurisdiction in similar rehabilitation proceedings. Although *Carpenter* does not really discuss the jurisdictional issue, the opinion in *Mullane* announced what has come to be called the doctrine of "jurisdiction by necessity." *See* Fraser, *Jurisdiction By Necessity – An Analysis of the Mullane Case,* 100 U. Pa. L. Rev. 305 (1951). The doctrine of "jurisdiction by necessity" allows a court to adjudicate conclusively rights of persons over whom it would not otherwise have jurisdiction where the question presented is one that must be decided and it is not possible for that court or any court to obtain jurisdiction over all those whose rights will be affected. It is doubtful whether *Mullane* survives this Court's holding in *Shaffer v. Heitner* that all assertions of state-court jurisdiction be evaluated according to a "minimum contacts" analysis. *See Shaffer v. Heitner,* 433 U.S. at 211 n.37; Brilmayer, *How Contacts Count: Due Process Limitations on State Court Jurisdiction,* 1980 Sup. Ct. Rev. 77, 105-10.

In applying a minimum contacts analysis, it would seem that all of the North Carolina policyholders' affiliating circumstances are with North Carolina, not Indiana. The

only discernible contact between the North Carolina policyholders and Indiana is that UNAC is a corporation domiciled in Indiana. The North Carolina policyholders, however, negotiated and purchased their insurance in North Carolina. As a result of its conduct of business in North Carolina, UNAC was subject to North Carolina's comprehensive insurance regulation, requiring it to place a special deposit in trust in North Carolina. The North Carolina policyholders had every reason to believe that any dispute that should arise regarding their relationship with UNAC would be resolved in a North Carolina forum, not that they would be "haled into court" in Indiana. *World-Wide Volkswagen Corp. v. Woodson,* 444 U.S. at 297.

Many of the same considerations that would lead a court to exercise "jurisdiction by necessity" are also applicable in a "minimum contacts" analysis. If an insolvent insurer is to be rehabilitated, there must be one court empowered to compromise and adjust the contractual rights of all policyholders. The exercise of jurisdiction by the Indiana court would, therefore, advance both the interest of Indiana in providing a forum for the rehabilitation of its domiciliary insurance company and the interests of the interstate judicial system in the efficient resolution of disputes. *See World-Wide Volkswagen Corp. v. Woodson,* 444 U.S. at 292. More important, the exercise of jurisdiction by the Indiana court for the limited purpose of modifying policy rights is neither unfair to the North Carolina policyholders nor an encroachment on the sovereignty of North Carolina. *See* Note, *Multistate Plaintiff Class Actions: Jurisdiction and Certification,* 92 Harv. L. Rev. 718, 732 (1979). There is no readily apparent policy of North Carolina upon which such a limited exercise of jurisdiction would intrude. In fact, the North Carolina Supreme Court has recognized the ability of a domiciliary rehabilitation proceeding in another state to

modify contractual rights of policyholders residing in North Carolina. *Taylor v. Pacific Mutual Life Insurance Co.*, 214 N.C. 770, 200 S.E. 882 (1939).

For the narrow issue of modifying policy rights, therefore, it may be enough that UNAC is a corporation domiciled in Indiana. That is, to be sure, a modest claim to jurisdiction, but such an adjudication is itself modest.

None of these considerations apply, however, to the adjudication by the Indiana court that the North Carolina special deposit was a general asset of UNAC. For that determination the Indiana court was not exercising jurisdiction to decide a question for which there was no alternative forum. North Carolina is clearly an alternative forum and the only proper forum. North Carolina law requires that the special deposit be placed in trust, and the trust corpus, trustees and beneficiaries all are to be found in North Carolina. Since rights in the deposit could be readily adjudicated in North Carolina any action by the Indiana court regarding the deposit cannot, therefore, be characterized as an exercise of "jurisdiction by necessity."

Unlike the rights involved in the modification of policies, the rights claimed by the North Carolina policyholders in the North Carolina special deposit are statutory rights that are distinct from the rights asserted by other UNAC policyholders. The North Carolina policyholders cannot, therefore, assume that their interests will be fairly represented by other class members who would benefit if the North Carolina deposit were to be determined a general asset of UNAC. This limitation on the doctrine of virtual or class representation is not merely one imposed by local rule or procedure, but by the Constitution. *Hansberry v. Lee*, 311 U.S. 32 (1940); *see also* Note, *supra*, 92 Harv. L. Rev. at 732 & n.117.

Perhaps even more important is the violence that the Indiana adjudication does to the interests of North Carolina.

The special deposit here in question is required as a condition precedent to a foreign insurance company doing business in North Carolina. Distribution of the deposit is governed by North Carolina statutes. Its obvious purpose is to protect North Carolina policyholders in the event of the insolvency of a foreign insurer. The interest North Carolina has in making these statutory provisions to protect local policyholders cannot seriously be questioned. *See State Farm Mutual Automobile Insurance Co. v. Duel,* 324 U.S. 154 (1945); *Hoopeston Canning Co. v. Cullen,* 318 U.S. 313 (1943). In light of these interests of North Carolina in adjudicating claims on the deposit under its statutes, the assertion of jurisdiction by the Indiana court, based on such tenuous ties with those whose rights are affected, can only be seen as well outside the bounds of authority imposed by the federal system.

The apparent view of UNAC is that jurisdiction for adjudication of rights in the deposit by the Indiana court may be justified in light of the entire rehabilitation proceeding. Jurisdiction for this adjudication must stand on its own, however, and cannot be justified as a necessary adjunct to the rehabilitation proceeding. This Court in *Hanson v. Denckla,* 357 U.S. 235, rejected similar jurisdictional claims of a probate court. There the settlor of a Delaware trust died domiciled in Florida. The Florida probate court, applying Florida law, held that the trust was invalid because the settlor had reserved too much power over the trustee and the trust corpus, and that the corpus therefore passed under the residuary clause of the settlor's will. This Court held that the Florida probate court could not create for itself jurisdiction to determine the validity of the trust by declaring it to be a part of the estate over which it did have jurisdiction. "[J]urisdiction cannot be predicated upon the contingent role of this Florida will," the Court said. "Whatever the efficacy of a so-called *'in rem'* jurisdiction over assets admittedly pass-

ing under a local will, a State acquires no *in rem* jurisdiction to adjudicate the validity of *inter vivos* dispositions simply because its decision might augment an estate passing under a will probated in its courts." *Id.* at 248. Thus, the decree of the Florida court could not be conclusive of the interests of nonresidents over whom it had no jurisdiction. Similarly, in this case, the Indiana court could not create jurisdiction in itself to adjudicate rights in the deposit simply to augment the assets available to the Indiana rehabilitation court.

It is clear in this case that the Indiana court's adjudication respecting the North Carolina deposit is far more ambitious than its basis for rehabilitation jurisdiction can support. The considerations that favor its jurisdiction to modify uniformly the contractual rights of all UNAC's policyholders do not apply to its assertion of jurisdiction over the North Carolina special deposit. It is an attempt to extend a kind of "jurisdiction by necessity" far beyond the necessity. All the significant contacts were with North Carolina. That is where the distribution of the special deposit should be decided.

C. The North Carolina Court of Appeals Was Not Foreclosed From Addressing The Sufficiency Of The Indiana Court's Jurisdiction.

At page 34 of its brief UNAC argues that, under *Durfee v. Duke,* 375 U.S. 106, the North Carolina court was prohibited from adjudicating rights in the deposit held in trust in North Carolina. In so arguing, UNAC reasons that the issue of jurisdiction was fully and fairly litigated by the Indiana court and, therefore, the North Carolina court is prohibited from determining that the Indiana court lacked jurisdiction and then proceeding itself to adjudicate rights in the deposit. The November 22, 1976 order issued by the Indiana court contained a conclusory recitation that the

Indiana court had jurisdiction "over the subject matter and over the parties." (J.A. 38) However, the mere recitation of jurisdiction does not prevent a court in another state from inquiring into the foreign court's jurisdiction to render a judgment. *Durfee v. Duke,* 375 U.S. at 110; *Thompson v. Whitman,* 85 U.S. (18 Wall.) 457, 469 (1873).

Because the North Carolina courts held that the Guaranty Association sustained its burden of proof in showing that the Indiana court did not have jurisdiction, the burden of proof now rests on UNAC to disprove the North Carolina court's determination of its own jurisdiction, to disprove that that determination was reached by an appropriate procedure, and to disprove that the North Carolina courts' judgment was amply supported in evidence. *Williams v. North Carolina,* 325 U.S. 226, 234 (1945).

As required by *Durfee v. Duke,* the North Carolina Superior Court carefully considered whether the Indiana rehabilitation court had fully and fairly considered jurisdiction in the deposit and determined that "neither the deposit made by UNAC in North Carolina, nor the special legal rights of North Carolina policyholders in that deposit were specifically considered by the Indiana court in the rehabilitation order dated November 22, 1976." (Pet. App. 23A) Having thus determined that the Indiana court did not fully and fairly consider jurisdiction as to the deposit located in North Carolina, the North Carolina Superior Court determined that jurisdiction over the deposit rests with the North Carolina court and proceeded to determine rights in the deposit. The North Carolina Court of Appeals, in determining that the Indiana judgment was not entitled to full faith and credit, considered and affirmed the findings by the Superior Court as to the proceedings in Indiana. (Pet. App. 6A-13A. 15A.)

UNAC does not even attempt to argue that jurisdiction was fully and fairly considered by the Indiana rehabilitation court during the proceeding terminating in 1976. This is understandable, since neither the existence of the deposit, the rights under North Carolina statutes, nor the fact that title was held by North Carolina officials was mentioned by the Indiana court in its 1976 order. (J.A. 37-81) Rather, UNAC argues that the 1978 hearing held by the Indiana court on UNAC's petition for instructions regarding the service contract was a full and fair determination that the Indiana court had jurisdiction to deal with the deposit held in trust in North Carolina. (Brief p. 34) While it is apparent that the North Carolina court also considered the Indiana court's November 22, 1978 order (Pet. App. 24A), such consideration was not necessary. An examination of the November 22, 1978 order issued by the Indiana court clearly indicates that the 1978 hearing was not a *de novo* hearing as to jurisdiction and that the Indiana court made no specific finding as to jurisdiction. (Pet. App. 31A-41A) The 1978 order merely stated that the 1976 final Order and Plan cut off the statutory rights of North Carolina policyholders in the deposit held in trust in North Carolina. There is no basis for the argument that the 1978 hearing was a full and fair determination of jurisdiction, and there is certainly no basis for the bootstrap argument that any such determination should relate back to the 1976 final Order and Plan. It is clear that neither the North Carolina policyholders nor the Guaranty Association ever had "their day in court" on the issue of the Indiana court's treatment of the special deposit left in trust in North Carolina by UNAC, and the policyholders' statutory rights in that deposit. *See Lewis v. Hanson,* 36 Del. Ch. 235, 259, 128 A.2d 819, 834 (1957), *aff'd., Hanson v. Denckla,* 357 U.S. 235.

II. THE INDIANA JUDGMENT WAS RENDERED WITHOUT ANY NOTICE THAT THE DEPOSIT EXISTED OR THAT RIGHTS IN THE DEPOSIT WERE BEING ADJUDICATED.

UNAC repeatedly proclaims that the North Carolina policyholders and the Guaranty Association were notified of the rehabilitation proceeding. While sufficient notice that a rehabilitation proceeding was pending may have been given, neither the North Carolina policyholders nor the Guaranty Association was ever apprised of the existence of the deposit in North Carolina or of any anticipated abrogation of statutory rights in that deposit. The deposit was not mentioned in any of the notices to policyholders or the Plan of Rehabilitation. Further, it would not have been reasonably possible for anyone to determine that the deposit was included as an asset of UNAC for purposes of the rehabilitation. The only mention of assets subject to the rehabilitation proceeding was the single reference to the $31,171,988 amount in the Plan. (J.A. 66) Further, even in the unlikely event that a North Carolina policyholder would examine the convention blank filed by UNAC with the North Carolina Department of Insurance, the policyholders, like the Indiana court, would have been misled. Since UNAC's convention statement falsely listed the North Carolina deposit as being held for the benefit at all UNAC policyholders, the North Carolina policyholders would have been unaware of any special interest that should have been asserted before the Indiana court.

As this Court recently held in *World-Wide Volkswagen Corp. v. Woodson,* 444 U.S. at 291:

> A judgment rendered in violation of due process is void in the rendering State and is not entitled to full faith and credit elsewhere. *Pennoyer v. Neff,* 95 U.S. 714, 732-733 (1878). Due process

> requires that the Defendant be given adequate notice of the suit, *Mullane v. Central Hanover Trust Co.*, 339 U.S. 306 at 313-14 (1950), and be subject to the personal jurisdiction of the court.

In *Mullane*, this Court said "when notice is a person's due, process which is a mere gesture is not due process. The means employed must be such as one desirous of actually informing the absentee might reasonably adopt to accomplish it." *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. at 315. Because the decision in Indiana denied due process of law to the policyholder and the Guaranty Association, the North Carolina Court of Appeals properly refused to accord that decision full faith and credit.

III. THE INDIANA COURT IGNORED NORTH CAROLINA LAW IN DETERMINING RIGHTS IN THE NORTH CAROLINA DEPOSIT.

Even if the Indiana rehabilitation court had jurisdiction to determine rights in the North Carolina special deposit, it made no effort to apply North Carolina law to that determination. UNAC does not contend otherwise:

> UNAC argues, in effect, that judicial economy should override all other concerns to give the Indiana rehabilitation court jurisdiction to decide any question tending to affect the rehabilitation, regardless of how attenuated the contacts of the Indiana forum to that question. (Brief p. 25) Judicial economy cannot, however, excuse the Indiana court's disregard of North Carolina law governing distribution of the special deposit.

The concerns present here are much the same as in a minimum contacts analysis:

> In deciding constitutional choice-of-law questions, whether under the Due Process Clause or

> the Full Faith and Credit Clause, this Court has traditionally examined the contacts of the State whose law was applied, with the parties and with the occurrence or transaction giving rise to the litigation. In order to ensure that the choice of law is neither arbitrary nor fundamentally unfair, the Court has invalidated the choice of law of a State which has had no significant contact or significant aggregation of contracts, creating state interests, with the parties and the occurrence or transaction.

Allstate Insurance Co. v. Hague, ____U.S. ____, 101 S.Ct. 633, 637-38 (1981) (footnotes and citations omitted). *See* Kirgis, *The Role of Due Process and Full Faith and Credit in Choice of Law*, 62 Corn. L. Rev. 94 (1976).

The North Carolina policyholders had every reason to believe, upon purchasing insurance from UNAC, that they would be protected by North Carolina law should UNAC become insolvent. Instead they find themselves deprived of that protection by a forum without significant contacts with them. *See Home Insurance Co. v. Dick*, 281 U.S. 397 (1930).

Perhaps more important, as a result of that disregard of North Carolina law, North Carolina is now being asked to accord full faith and credit to a judgment that it antithetical to North Carolina law and interests. This Court has recognized that the judgment of one State can so interfere with important interests of another that the national policy of full faith and credit will not require that it be enforced there. *See, e.g., Magnolia Petroleum Co. v. Hunt*, 320 U.S. 430, 438 (1943); *Williams v. North Carolina*, 317 U.S. 287, 294-95 (1942); *see also* RESTATEMENT (SECOND) OF CONFLICTS OF LAWS § 103. This is just such a case. The intrusion on North Carolina's

important interests in regulating foreign insurers is unmistakeable. North Carolina cannot be forced to accede to the nullification of its laws.

IV. THE GUARANTY ASSOCIATION IS NOT ESTOPPED FROM ASSERTING ITS RIGHTS IN THE NORTH CAROLINA DEPOSIT.

UNAC also argues that the Guaranty Association is estopped from challenging the Plan of Operation and is bound by its terms. (Brief pp. 33-35) This theory of collateral estoppel without jurisdiction over the subject matter or the necessary parties was implicitly rejected by this Court in *Hanson v. Denckla,* 357 U.S. 235. *See, Lewis v. Hanson,* 36 Del. Ch. at 834, 128 A.2d at 819. In any event, because of the lack of notice of the nature and effect of the Indiana proceedings, it would be fundamentally unfair and a violation of the Due Process Clause to hold that the Indiana judgment rendered without sufficient jurisdiction or notice could bind the Guaranty Association.

CONCLUSION

For the reasons discussed above, the Respondents respectfully request that the decision of the North Carolina Court of Appeals be affirmed.

Respectfully submitted,

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APPENDIX

CHRONOLOGY OF EVENTS

Indiana	North Carolina
	1. 7-19-73 Deposit placed in N.C. in trust for sole protection of N.C. policyholders
	2. 2-26-74 UNAC filed convention blank in N.C. showing deposit as general asset rather than special deposit
1. 8-5-74 UNAC placed in rehabilitation proceeding pursuant to petition of Indiana Department of Insurance (J.A. 13)	
	3. 3-11-75 Rehabilitator filed convention blank on behalf of UNAC in N.C. showing deposit as general asset rather than special deposit
2. 10-30-75 Court certified class consisting of "all policyholders who now hold or have held contracts of insurance with UNAC" (J.A. 15; 48)	
	4. 3-1-76 Rehabilitator filed convention blank on behalf of UNAC in N.C. showing deposit as general asset rather than special deposit

3. 6-8-76 Eight guaranty associations, including the North Carolina Guaranty Association intervened (Ex. Bd. 98, J.A. 49)

4. 6-9-76 Hearing held on proposed plan of rehabilitation (Ex. Bd. 114)

5. 6-19- or 7-19-76 Court tentatively approved proposed plan of rehabilitation (J.A. 37; 50)

6. 10-12-76 Eight Guaranty Associations petition court regarding form letter to policyholders covered by guaranty associations and the concept of a service contract (J.A. 27)

7. 10-14-76 Final hearing on Plan of Rehabilitation held (J.A. 50)

8. 11-22-76 Plan of Rehabilitation approved and all inconsistent claims that were, or could have been, presented were dismissed (J.A. 37)

9. 2-4-77 UNAC's court-appointed trustees elect Board of Directors and UNAC released from rehabilitation (J.A. 120)

10. 6-8-77 Joint Petition for Instructions filed by UNAC and eight guaranty associations regarding approval of proposed Service Agreement (J.A. 89)

11. 6-14-77 Court approved Service Contract (J.A. 118)

12. 12-5-77 UNAC first informed N.C. Guaranty Association of its contention that the rehabilitation proceeding affected statutory rights of N.C. policyholders in deposit placed in trust in N.C. (R. 23; Ex. Bd. 35)

5. 1-12-78 N.C. Guaranty Association filed complaint in Wake County, N.C. Superior Court seeking a declaratory judgment regarding rights in deposit held in trust in N.C. (J.A. 99)

13. 7-13-78 UNAC filed petition for instructions asking how to proceed under the service contract in light of litigation over deposit initiated in N.C. (J.A. 111)

14. 9-20-78 Hearing held regarding UNAC's petition for instructions at which the Guaranty Association asserted its full faith and credit claims as to

North Carolina statutes (Pet. App. 32A)

15. 11-22-78 Indiana court entered order holding that November 22, 1976, Final Order and Plan of Rehabilitation dismissed any claim by a N.C. policyholder or by the Guaranty Association against the deposit (Pet. App. 31A-41A)

16. 12-19-78 Guaranty Association appealed November 22, 1978 order to Indiana Court of Appeals raising full faith and credit and jurisdictional claims. (Pet. App. 25A)

6. 3-19-79 Hearing before N.C. Superior Court held on cross motions for summary judgment (Pet. App. 19A)

7. 4-11-78 N.C. Superior Court entered summary judgment order holding that Indiana rehabilitation court violated the full faith and credit clause and lacked jurisdiction to abrogate statutory rights of N.C. policyholders in deposit held in trust in N.C., and that deposit should be liquidated for the benefit of North Carolina policyholders (Pet. App. 19A-28A)

8. 4-20-79 UNAC appealed North Carolina Superior Court decision to North Carolina Court of Appeals (R. 52)

9. 9-2-80 N.C. Court of Appeals unanimously affirmed decision of N.C. Superior Court (Pet. App. 5A-16A)

10. 10-6-80 UNAC filed Notice of Appeal and Alternate Petition for Discretionary Review with the N.C. Supreme Court (J.A. 6)

11. 12-4-80 N.C. Supreme Court entered judgment dismissing UNAC's Appeal and denying UNAC's Petition for Discretionary Review (Pet. App. 1A)

12. 3-3-81 UNAC filed a Petition for Certiorari with the United States Supreme Court

17. 3-11-81 Indiana Court of Appeals heard oral argument on the Guaranty Association's appeal and stayed its consideration of the appeal pending action by the United States Supreme Court of this certiorari proceeding

13. 5-18-81 United States Supreme Court granted certiorari

SPECIAL DEPOSIT SCHEDULE

Showing all deposits or investments NOT held for the protection of ALL the policyholders of the Company

WHERE DEPOSITED	DESCRIPTION AND PURCHASE OF DEPOSIT (Indicating Literal Form of Registration of Securities)	PAR VALUE	STATEMENT VALUE	MARKET VALUE
	NONE			
	Totals			

SCHEDULE OF ALL OTHER DEPOSITS

Showing all deposits made with any Government, Province, State, District, County, Municipality, Corporation, firm or individual, except those shown in Schedule E and those shown in "Special Deposit Schedule" above

WHERE DEPOSITED	DESCRIPTION AND PURCHASE OF DEPOSIT (Indicating Literal Form of Registration of Securities)	PAR VALUE	STATEMENT VALUE	MARKET VALUE
• • • • • • • • • • • •	(preceding entries deleted)			
North Carolina Insurance Department	Inter-American Development Bank, 6.625%, due 11/1/93	100,000.00	80,182.53	80,000.00
• • • • • • • • • • • •	(subsequent entries deleted)			
	Totals	3,370,648.48	2,926,349.43	2,698,835.29

SPRING TERM 1981

IN THE SUPREME COURT OF NORTH CAROLINA

STATE OF NORTH CAROLINA, ON RELATION OF JOHN RANDOLPH INGRAM, COMMISSIONER OF INSURANCE OF NORTH CAROLINA,

Plaintiff

v.

RESERVE INSURANCE COMPANY,

Defendant

and

NORTH CAROLINA INSURANCE GUARANTY ASSOCIATION,

Third-Party Plaintiff

and

PHILIP R. O'CONNOR, AS DIRECTOR OF INSURANCE OF THE STATE OF ILLINOIS AND AS DOMICILIARY RECEIVER OF RESERVE INSURANCE COMPANY,

Third-Party Defendant

and

ROBERT P. BINKLEY, BENJAMIN T. SIMMONS, JR., WALLACE GRAHAM GETCHELL, AND ARNOLD ENGLAND, INDIVIDUALLY AND AS REPRESENTATIVE OF THE POLICYHOLDERS OF RESERVE INSURANCE COMPANY WHO ARE CITIZENS OR RESIDENTS OF NORTH CAROLINA OR WHO HOLD POLICIES ISSUED UPON PROPERTY IN NORTH CAROLINA, AND CAROLINA INSURANCE SERVICE, INC.

Third-Party Plaintiffs

Filed August 17, 1981
IN THE OFFICE OF CLERK SUPREME COURT
OF NORTH CAROLINA

No. 113-Wake

Appeal by the Commissioner of Insurance and third-party plaintiffs Carolina Insurance Service, Inc., and Binkley, et al., from decision of the Court of Appeals, 48

N.C. App. 643, 269 S.E.2d 757 (1980), reversing judgment of Hobgood, J., at the 6 July 1979 Session of WAKE Superior Court.

These proceedings were spawned by the insolvency of Reserve Insurance Company, an Illinois corporation doing business in North Carolina. On 7 May 1979 Reserve was enjoined by the Circuit Court of Cook County, Illinois from doing business except with the consent of the Illinois Director of Insurance. On 16 May 1979, the North Carolina Commissioner of Insurance ordered Reserve to cease writing new or renewal business in this State until its minimum maintained capital was restored. Reserve was adjudicated insolvent, and the Illinois director of Insurance was appointed "Domiciliary Receiver" on 29 May 1979, with powers to liquidate the business affairs of Reserve. The North Carolina Commissioner of Insurance filed this action against Reserve on 31 May 1979 pursuant to the Uniform Insurers Liquidation Act which is codified as part of Article 17A of Chapter 58 of the General Statutes.

The Commissioner alleged the insolvency of the defendant company and sought appointment as receiver in North Carolina. The Commissioner was appointed "Ancillary Receiver," and a restraining order was entered. This initial order of the North Carolina Court was followed by a preliminary injunction and order continuing the receivership on 8 June 1979. The relief sought was not resisted by Reserve and judgment by default was entered on 14 September 1979 making the ancillary receivership permanent. On the same date, the superior court entered a separate order requiring the Commissioner as "Ancillary Receiver" to liquidate Reserve's North Carolina assets, process claims and file his report with the court.

The only asset of Reserve in North Carolina is a special deposit of securities having a face value of $185,000. The securities were deposited with the Treasurer of North Carolina pursuant to Article 20 of Chapter 58 of the General Statutes as a condition of doing business in North Carolina. Reserve was required to deposit the securities and give the Commissioner a power of attorney to use the securities to pay liabilities of North Carolina policyholders resulting from any default of Reserve.

The North Carolina Insurance Guaranty Association also began operations to pay liabilities and claims for North Carolina policyholders resulting from the insolvency of Reserve. The Guaranty Association was created by the Insurance Guaranty Association Act, which is Article 17B of Chapter 58 of the General Statutes. The Association is composed of all casualty insurance companies which transact business in North Carolina. When a member company is adjudged insolvent by a court of competent jurisdiction, the Association bears the responsibility for paying claims against the company which are greater than $100 but not to exceed $300,000 per claim. The payments are financed through membership assessments.

On 8 June 1979, the Guaranty Association filed a motion, which was allowed, to intervene in the Commissioner's liquidation suit. On 15 June 1979, the Guaranty Association filed an "answer, counterclaims, crossclaims, and third-party complaint," the basic purpose of which was to assert the Association's rights to the special securities deposit both as lienor and under a piece of legislation enacted by the General Assembly on 23 May 1979 as part of the Insurance Guaranty Association Act entitled the "Quick Access Statute" and codified as G.S. 58-155.60. A motion for partial summary judgment was

filed with this pleading requesting the court to enter judgment declaring the Guaranty Association's right to have the special deposit of Reserve delivered to the Association to pay covered claims as provided in G.S. 58-155.60. The Commissioner as ancillary receiver in answer denied the essential allegations of the Guaranty Association.

On 2 July 1979, Carolina Insurance Service, Inc.,[1] the general agent for Reserve in North Carolina and several individual policyholders on their own behalf and on behalf of other individual policyholders with Reserve, filed motions to intervene in the liquidation suit which were allowed. These third-party plaintiffs sought a declaratory judgment (1) that the policyholders of Reserve had a lien on the special deposit superior to that of the Guaranty Association and (2) that the deposit not be delivered to the Guaranty Association. On the same day, the Commissioner as Ancillary Receiver moved to dismiss the claim of the Guaranty Association to the deposit, alleging G.S. 58-155.60 was void and unconstitutional.

The superior court heard arguments of the parties concerning disposition of the special deposits. The Guaranty Association contended G.S. 58-155.60 gave it a right to the deposit to cover *claims and expenses* arising out of the insolvency of Reserve. The Commissioner, Carolina Insurance Service, Inc. and the individual policyholders argued that allowing the Guaranty Association's claim to the special deposit pursuant to G.S. 58-155.60 would interfere with a vested property right of the policyholders in that it would unlawfully and retroactively divest them of

[1]Carolina Insurance Service, Inc., alleged it held $81,326.25 in funds, representing premiums for policies written prior to the liquidation proceeding. Carolina sought to create a trust for its policyholders in these funds and determine whether they should be paid to the domiciliary receiver or the ancillary receiver. These questions raised by Carolina are not at issue in this appeal.

their lien rights in the special deposits as specified in G.S. 58-185.

On 6 July 1979, the superior court denied the Guaranty Association's motion for summary judgment. In support of this order, the superior court listed these material facts which were not excepted to by any party on appeal: (1) Reserve was adjudicated insolvent on 29 May 1979; (2) there were more than 1700 policyholders in North Carolina who held contracts of insurance with Reserve written between 30 May 1978 and 7 May 1979; (3) all these policyholders will be entitled to return of the unearned premiums by virtue of the insolvency; (4) the total amount of unearned premiums equals approximately $184,528.49 of which amount approximately $89,096.78 represents claims to be paid by the Guaranty Association and $95,431.71 represents total unearned premiums up to a maximum of $100 on each policy which will not be paid by the Guaranty Association; and (5) the Quick Access statute, G.S. 58-155.60 was enacted on 23 May 1979 with an effective date of 23 May 1979. The court then concluded as a matter of law that G.S. 58-155.60 could be applied prospectively only and therefore not to the insurer insolvency in question in this case and that the policyholder liens against the special deposits pursuant to G.S. 58-185 were superior to any rights of the Guaranty Association. The Guaranty Association appealed to the Court of Appeals.

The Court of Appeals reversed the superior court and remanded the case, ordering that the special deposits be delivered to the Guaranty Association. That court reasoned G.S. 58-155.60 could be applied retroactively. The Court of Appeals stated:

> We hold that the superior court committed error when it did not order the deposits of Reserve

> delivered to the Guaranty Association. The claimants under G.S. 58-185 will retain their lien rights and may proceed against the Guaranty Association to the extend of the deposit for any claims they may have had under G.S. 58-185 which are not satisfied by the Guaranty Association.

48 N.C. App. at 648, 269 S.E.2d at 760.

The Commissioner as Ancillary Receiver, Carolina Insurance Service, Inc., and the individual policyholders appealed to this Court which granted their petitions for discretionary review pursuant to G.S. 7A-31.

> RUFUS L. EDMISTEN, Attorney General, by RICHARD L. GRIFFIN, Assistant Attorney General, for State of North Carolina ex rel. Commissioner of Insurance, plaintiff appellant .
>
> CRAIGE, BRAWLEY, LIIPFERT & ROSS, by COWLES LIIPFERT, C. THOMAS ROSS and TERRIE A. DAVIS, Attorneys for Carolina Insurance Service, Inc., Robert P. Binkley, Benjamin T. Simmons, Jr., Wallace Graham Getchell and Arnold England and the North Carolina policyholders of Reserve Insurance Company, third-party plaintiff appellants.
>
> ALLEN, STEED and ALLEN, P.A., by ARCH T. ALLEN, III, and ANN HOGUE PAPPAS, Attorneys for North Carolina Insurance Guaranty Association, third-party plaintiff appellee.

HUSKINS, Justice:

This case involves construction of G.S. 58-155.60, the "Quick Access" statute, and whether it applies retroactively to divest the lien of North Carolina policyholders of

Reserve, whose policies were issued before the statute was enacted into law, in certain securities deposited by Reserve to cover claims in the event of its default. We conclude the statute can be applied constitutionally to the present case.

Before we explain the effect of G.S. 58-155.60 in the present case, some background information is relevant to show how our regulated insurance industry operates when a foreign insuring company defaults on its obligations in this State.

Three separate articles of Chapter 58 of the General Statutes apply to the present case: Article 20—Deposits by Insurance Companies, originally enacted in 1909; Article 17A— Mergers, Rehabilitation and Liquidation of Insurance Companies, which contains the Uniform Insurers Liquidation Act, originally enacted in 1947; and Article 17B—the Insurance Guaranty Association Act, originally enacted in 1971. The older articles were neither repealed nor superseded by the later articles. All the provisions have one basic purpose: to better protect North Carolina claimants and policyholders. The interrelationship of the provisions is readily apparent on the facts of this case: The security deposit of Reserve was made and held pursuant to Article 20; the ancillary receivership of the Commissioner was established pursuant to Article 17A and the Guaranty Association is paying claims and liabilities pursuant to Article 17B.

Beginning in 1909, the State required certain insurance companies to make deposits with the Commissioner of Insurance. G.S. 58-182. Foreign casualty companies such as Reserve have been required to make deposits since 1945. G.S. 58-182.1. Such deposits are a prerequisite for a license to do business in this State. G.S. 58-188. The deposits are in an amount specified by statute, G.S.

58-182, -182.1, -182.2, and are not made in currency but in bonds of the United States, North Carolina or cities and counties of this State. G.S. 58-182.3. The deposits are to be delivered by the Commissioner to the Treasurer of the State for safekeeping to "be held exclusively and solely for the protection of contract holders." G.S. 58-182.6; *see also* G.S. 58-188.1. The depositing insurance company is entitled to the interest from the securities "until the company fails to pay any liability arising upon any" covered policy, "and thereafter the interest, so long as the liability exists shall be payable to the Commissioner of Insurance, to be applied, if necessary, to the payment of such liability." G.S. 58-183.

The deposit statutes also require a power of attorney to the Commissioner "authorizing the sale or transfer of said securities or any part thereof for the purpose of paying any of the liabilities provided for in this Article." G.S. 58-182.5. "If the company fails to pay any of its liabilities on its contracts . . ., the Commissioner of Insurance shall, upon application of the party to whom the debt or money is due, . . . proceed to sell at public auction such an amount of securities as, with the interest in his hands, will pay the sum due and expenses of sale, and out of the proceeds of sale pay said sums and expenses . . . ." G.S. 58-184. G.S. 58-185 creates a lien in the deposit for policyholders and a procedure[2] for disposition of the funds on deposit in the event of insolvency of an insurer as follows:

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[2]This procedure for disposition was altered by the adoption of the Uniform Insurers Liquidation Act in 1947 in that the ancillary receiver of a foreign insurer is to liquidate "special deposit claims." G.S. 58-155.12(b).

> Upon the securities deposited with the Commissioner of Insurance by any such insurance company, the holders of all contracts of the company who are citizens or residents of this State at such time, or who hold policies issued upon property in the State, shall have a lien for the amounts due them respectively, under or in consequence of such contracts for losses, equitable values, return premiums, or otherwise, and shall be entitled to be paid ratably out of the proceeds of said securities, if such proceeds be not sufficient to pay all of said contract holders. When any company depositing securities as aforesaid becomes insolvent or bankrupt or makes an assignment for the benefit of its creditors, any holder of such contract may begin an action in the Superior Court of the County of Wake to enforce the lien for the benefit of all the holders of such contracts. The Commissioner of Insurance shall be a party to the suit, and the funds shall be distributed by the court, but no cost of such action shall be adjudged against the Commissioner of Insurance.

See also G.S. 58-188.1. Deposits pursuant to Article 20 constitute a *trust* for the benefit of North Carolina policyholders and are not *assets* of the insolvent insurance company. Continental Bank & Trust Co. v. Gold, 140 F.Supp. 252 (E.D.N.C. 1956); 2 Couch on Insurance §§ 22:94, 22:96, 22:111 (2d Ed. 1959); 19 Appleman, Insurance Law and Practice § 11094 (1979 Supp.); *see also* Guaranty Association v. Assurance Co., 48 N.C. App. 508, 269 S.E.2d 688, *cert. den.*, 301 N.C. 527, 273 S.E.2d 453 (1980), *cert. granted,* _____U.S._____, 68 L.Ed.2d 838, _____S.Ct._____(1981). Such deposits supplement

the general corporate law which does little to protect claimants and policyholders of insolvent insurers. Reserve made deposits pursuant to Article 20 having a face value of $185,000. The policyholders are entitled to the lien provided for in G.S. 58-185.

The deposits required by Article 20 and the general corporate law did not go far enough to protect North Carolina policyholders and claimants. To further this desired protection, the legislature adopted in 1947 as part of Article 17A the Uniform Insurers Liquidation Act. *See* 25 N.C. L. Rev. 429 (1947). It provides the mechanism for liquidation of Reserve. Illinois has also adopted the Uniform Insurers Liquidation Act. Ill. Rev. Stat. Ch. 73 §§ 833.1 to 833.13. A domiciliary receiver was appointed in Illinois. Under the Act, the Commissioner is appointed ancillary receiver in this State. G.S. 58-155.9(b); G.S. 58-155.12(a).

Both the North Carolina and Illinois versions of the Uniform Act make specific reference to "special deposits" and recognize the right of an ancillary receiver to liquidate claims against these deposits. G.S. 58-155.10(11), -155.12(b) and -155.15(c); Ill. Rev. Stat. Ch. 73§§ 833.1(8), 833.6 and 833.8. A "special deposit claim" is defined as "any claim secured by a deposit made pursuant to statute for the security or benefit of a limited class or classes or persons. . . ." G.S. 58-155.10(11). The funds in question in this case are such deposits. Such deposits are expressly excluded from general assets. G.S. 58-155.10(5). The ancillary receiver "shall, as soon as practicable, liquidate from their respective securities those special deposit claims . . . which are proved and allowed in this State. . . ." G.S. 58-155.12(b). "The owners of special deposit claims against an insurer for which a receiver is appointed in this or any other state shall be given priority

against their several special deposits in accordance with the provisions of the statutes governing the creation and maintenance of such deposits." G.S. 58-155.15(c). Thus, whatever Article 20, *i.e.*, G.S. 58-185, says about priorities, controls. Article 17A merely provides supplemental procedures to expedite the liquidation process and specifies the date on which all rights are fixed:

> The rights and liabilities of the insurer and of its creditors, policyholders . . . and all other persons interested in its estate shall, unless otherwise directed by the court, be *fixed as of the date on which the order directing the liquidation of the insurer is filed* in the office of the clerk of the court which made the order, subject to the provisions of G.S. 58-155.29 with respect to the rights of claimants holding contingent claims.

G.S. 58-155.25 (emphasis added).

In 1971, the legislature effected additional protection for North Carolina policyholders by enacting Article 17B, creating an organization, the Insurance Guaranty Association, which would promptly ascertain claims against an insolvent insurer and pay each covered claim of $100 to $300,000 which arises within thirty days of a determination of insolvency. G.S. 58-155.48(a)(1). The purpose of The Association "is to provide a mechanism for the payment of covered claims under certain insurance policies, to avoid excessive delay in payment, and to avoid financial loss to claimants or policyholders because of the insolvency of an insurer. . . ." G.S. 58-155.42. At least forty-five states have enacted versions of a Model Post-Assessment Guaranty Association Act. *See* Hank, Post-Assessment Guaranty Funds: Are They the Ultimate Solution to the Insolvency Problem? 1976 Insurance Law Journal 482. It serves as an adjunct to normal liquidation proceedings.

See Cooper Claims Service v. Arizona Insurance Guaranty Ass'n., 22 Ariz. App. 16, 158, 524 P.2d 1329, 1331 (1974). The Guaranty Association is a non-profit unincorporated legal entity which covers all property and casualty insurance business transacted in North Carolina. G.S. 58-155. All insurance companies licensed to transact business in North Carolina and not exempted by G.S. 58-155.43 must become members of the Association. G.S. 58-155.46. The Association acts as insurer. G.S. 58-155.48(a)(2).

To pay covered claims, the Guaranty Association assesses its members based upon the percentage of business transacted in North Carolina. G.S. 58-155.48(a)(3). The Association has the power to borrow funds to pay covered claims. G.S. 58-155.48(b)(2). Once the Association pays a claim, any person receiving payment "shall be deemed to have assigned his rights under the policy to the Association to the extent of his recovery from the Association." G.S. 58-155.51(a). The Act also provides that "[t]he expenses of the Association . . . shall be accorded the same priority as the liquidator's expenses." G.S. 58-155.51(b).

This is a basic outline of the law as it existed in May 1979 when Reserve was adjudicated insolvent and G.S. 58-155.60 was enacted by the legislature. The parties refer to this statute as the "Quick Access" statute, and it is captioned "use of deposits made by insolvent insurer." It reads in pertinent part as follows:

> Notwithstanding any other provision of Chapter 58 of the General Statutes pertaining to the use of deposits made by insurance companies for the protection of policyholders, the Commissioner shall deliver to the Association, and the

> Association is hereby authorized to expend, any deposit or deposits previously or hereinafter made, whether or not required by statute, by an insolvent insurer to the extent those deposits are needed by the Association first to pay the covered claims in excess of one hundred dollars ($100.00) as required by this Article and then to the extent those deposits are needed to pay all expenses of the Association relating to the insurer.
>
> The Association shall account to the Commissioner and the insolvent insurer for all deposits received from the Commissioner hereunder, and shall repay to the Commissioner a portion of the deposits received which shall be equal to an amount computed by adding the lesser of the amount of the covered claim or one hundred dollars ($100.00) for each covered claim. Said repayment shall in no way prejudice the rights of the Association with regard to the portion of the deposit repaid to the Commissioner. After all of the deposits of the insolvent insurer have been expended by the Association for the purposes set out in this section, the member insurers shall be assessed as provided by this Article to pay any remaining liabilities of the Association arising under this Article.

The statute was ratified a week before Reserve was adjudged insolvent. The legislature specified that the Act would become effective upon ratification. 1979 N.C. Sess. Laws c. 628, § 2. The Guaranty Association sought access to the special deposits pursuant to this statute and was opposed by both the Commissioner and policyholders of Reserve.

No one contends the Quick Access statute fails to pass constitutional muster except in its application to the facts of this case. The policyholders contend that application of the statute's provisions to the Reserve insolvency will result in a retroactive divestment of the liens of North Carolina policyholders which were effective before the statute was ratified. The Commissioner contends that although the Guaranty Association has the right to use the deposits pursuant to the Quick Access statute, the Association is required to repay him the full amount of the deposit.

The Guaranty Association contends the Quick Access statute is a procedural and remedial statute intended to expedite payment of claims against the insolvent insurer by using the special deposit to pay those claims directly rather than later reimbursing the Guaranty Association for the claims. Thus, it does not divest policyholders of any rights in the deposits but merely provides an expedited procedure for obtaining those deposits. The Association also contends the Commissioner is not entitled to a full repayment of deposits.

The Quick Access statute applies "[n]otwithstanding any other provision of Chapter 58 of the General Statutes pertaining to the use of deposits made by insurance companies for the protection of policyholders . . . ." The statute thus controls should there be any conflict in preexisting provisions. The statute goes on to provide that "the Commissioner shall deliver to the Association" and "the Association is hereby authorized to expend . . ." the deposit. The statute expressly mandates the delivery to and use of the deposit by the Guaranty Association. The statute applies "to any deposit or deposits previously or hereinafter made . . . ." This coupled with the legislative mandate that the statute apply on ratification is a clear ex-

pression that the legislature intended the statute to apply to the present case. The policyholders make four arguments that this retroactive application of the statute creates new classes and priorities of claims against deposits.

The policyholders argue that as the Association pays claims and expenses from the deposit, the "lien would dwindle and possibly disappear." This is not so. The lien of the policyholders remains as long as needed. The Association has subrogation rights to the liens. G.S. 58-155.51(a). Thus, as the Association pays claims, it continuously acquires the liens. Once the Guaranty Association has paid claims between $100 and $300,000, and has returned deposit funds covering claims less than $100, all liens in the deposit pursuant to G.S. 58-185 are extinguished or have been acquired by the Association. The policyholders still have a lien until satisfied by the Association or the Commissioner. The lien rights of policyholders transfer with the deposit proceeds when they pass from the Commissioner to the Association. *See* Surety Corp. v. Sharpe, 236 N.C. 35, 72 S.E.2d 109 (1952).

The policyholders next argue that the statute eliminates interest on the deposit that would otherwise be earned and applied to payment of liabilities pursuant to G.S. 58-183. The only policyholders who can complain on this point are those with claims under $100. All other claims are promptly paid by the Association. The loss in interest is de minimis, particularly in light of the Association's quicker payment of claims in amounts greater than the deposits.

The policyholders contend that G.S. 58-155.48(a)(1) creates an entirely separate class of claims not covered by G.S. 58-185. The Association is required by G.S. 58-155.48(a)(1) to pay claims on policies terminated by the

insolvency of an insurer arising within a thirty-day period *after* the adjudication of insolvency and before an insured has replaced the policy. On the other hand, G.S. 58-155.25 fixes the rights and liabilities of the parties as of the day of insolvency unless otherwise specified by the court. Along the same lines, the policyholders, contend the "$100-over $300,000-under" exclusion conflicts with the pro rata distribution requirement of G.S. 58-185, thus extending coverage at the expense of their liens. This is not so. Neither the thirty-day extension nor the amount of the exclusion expands the liens. The liens of policyholders remain the same and remain limited pro rata "for the amounts due them." G.S. 58-185.

Finally, the policyholders argue that the Association can consume the deposit funds for Association expenses and thereby dilute their fixed rights. Such is not the case. The statute does authorize the use of deposits after claims of over $100 are paid "to the extent those deposits are needed to pay all expenses of the Association relating to the insurer." G.S. 58-155.60. However, this is only a temporary use. All deposits must be applied to claims and liabilities except for a minor amount related to the Commissioner's expenses in selling the bonds. G.S. 58-184. The only rights the Association has against the deposits are the subrogation rights under G.S. 58-155.51(a). The Association does not have a right to debit deposits for its expenses unless *all* deposit liens are satisfied and there is a surplus of deposit proceeds.

The expenses of the Association are accorded "the same priority as the liquidator's expenses." G.S. 58-155.51(b). However, that priority extends only to general assets. Special deposits are not general assets. Thus, the mechanism of this statute does nothing to dilute any rights of policyholders.

The Commissioner contends the Association is required to repay all of the deposit to the Commissioner. His authority for this contention is the statute's provisions that "the Association shall *account* to the Commissioner and the insolvent insurer for all deposits received from the Commissioner hereunder." The Commissioner would have us construe the word "account" to mean "pay over" to the receiver the entire special deposit of $185,000. The Commissioner also cites G.S. 58-155.51(c), which requires the Association to file statements with the liquidator or receiver to "preserve the rights of the Association against the assets of the insolvent insurer," as authority for his position that the Association has only temporary use of the deposits. We reject the Commissioner's argument insofar as it would require absurd repayments of funds the Association has paid to policyholders. The Association must account to the Commissioner on how it uses and applies *all* the funds. When all is said and done, it must establish that every cent of the money was applied to claims or was returned to the Commissioner. The Association can use the funds at the outset to cover its operating expenses. However, the Association has no permanent right in these funds for operating expenses unless all claims are paid and deposit funds remain. Thus, the only repayment to the Commissioner is for the claims under $100 which the Association is not authorized to pay. After all claims are paid, deposit funds can be used by the Association and not refunded to the Commissioner since he would then have no claimants to reimburse.

In summary, the Court of Appeals was correct in its interpretation of G.S. 58-155.60 as not affecting the lien rights of policyholders under G.S. 55-185. The Association has the initial right to use deposit funds to cover operating expenses incident to the insolvent. However, *all*

deposit funds must be paid to claimants pro rata as provided by G.S. 55-185. If all claimants are satisfied either directly by the Association or by the Commissioner (if the claim is under $100) and deposit funds remain, then and only then are such funds to be permanently credited to the Association for its expenses. These deposit funds which are provided to the Association as "seed money" must bear fruit for the policyholders and claimants for whom they were placed in trust.

For the reasons stated, the decision of the Court of Appeals is

Modified and Affirmed